


## City of Alexandria, Virginia

## MEMORANDUM

DATE: APRIL 21, 2004

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: PHILIP SUNDERLAND, CITY MANAGER 

SUBJECT: CONSIDERATION OF PROVIDING COMMENTS ON THE VIRGINIA-AMERICAN WATER COMPANY PROPOSED RATE INCREASE

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**ISSUE:** City Council consideration of providing comments on the Virginia-American Water Company proposed rate increase.

**RECOMMENDATION:** That City Council authorize City staff to provide comments to the State Corporation Commission in opposition to the proposed 8.15% increase in the Virginia-American Water Company's Alexandria District rates.

**DISCUSSION:** As detailed in the January 30, 2004 memo to Council, the Virginia-American Water Company (Water Company) filed with the State Corporation Commission (SCC) for a 8.15% rate increase for the Alexandria District (Case No. PUE 2003-00539). Under SCC rules, this rate increase became effective in March 2003 (subject to refund if the SCC later determines a lower rate increase was appropriate). The 8.15% rate increase is driven largely by new capital investments in the Water Company's Alexandria infrastructure and increased security costs. These investments are consistent with City Council's previously articulated desire for the Water Company to increase capital investments in the infrastructure that delivers water to City customers.

City staff has reviewed the rate case documents and recommends that the City of Alexandria submit formal comments to the SCC in objection to the proposed general increase of 8.15% in water rates. Staff found that the rate case documentation contained sufficient information to support some rate increase, but not as large an increase as requested. The following are items that staff noted in the rate case documentation:

- Since December 2001, when the Water Company last filed for a rate increase, the Water Company has invested approximately \$2 million in improvements to the facility that supports Alexandria customers. This investment included replacing water mains in Braddock Road, N. Overlook Dr., North View Terrace, Little St., Eisenhower Ave. and Mansion Dr. Part of the Water Company's utility plant is used to support the Fairfax County Water Authority. The cost of the utility plant used by the Fairfax County Water Authority is paid for by the Authority and is not part of the rate case considered by the SCC.

- Comparing the annual revenues and expenses for the test year from the prior rate case (test year ended December 31, 2001) to this rate case (test year ended September 25, 2003), a period of approximately 21 months, operating revenues decreased 1.9%, operation and maintenance expenses increased 8.4%, depreciation and amortization increased 13.4% and interest expense increased 1.8%. This resulted in a 45.0% decrease in Income Available for Common Equity.
- The Water Company's rate of return on Common Equity during the test year was 4.82%. They are requesting enough revenues to increase their current rate of return to 10.75%. This is the same rate of return they requested in 2002, however, the Water Company withdrew its request before the SCC completed its analysis. This rate of return is equal to the 10.75% that the SCC currently permits. Given current low capitalization rates in the commercial investment arena and the low risk that a water service operation in Alexandria represents, it is difficult to see how a 10.75% rate of return can be justified.

City staff is not convinced of the merits of all cost savings associated with the rate increase request for the following reasons:

- Decrease in Revenues: The revenues and expenses used in rate cases are based on an historical test year. This year's rate case is based on the historical test year ended September 26, 2003. The prior rate case was based on the historical year ended December 31, 2001. This year's test year had 438 fewer residential customers than the previous test year (85,466 residential customers in 2003 compared to 85,904 customers in 2001). This does not seem possible with the City's growth in population and the large residential development such as Cameron Station. When comparing this year's rate case to the last rate case, the Water Company also sold 5.8% less water to residential customers, 2.4% less water to commercial customers and 10.2% less water to industrial customers. This year's rate case filing by the Water Company assumes fewer gallons of water sold than the 1999 and 2000 rate case filings. The City's commercial base is growing, as evident by the Patent and Trade Office project and the City's growing population. Therefore, the water usage in this year's rate case must be an anomaly and should not be used to adjust the City's water rates. When questioned, the Water Company staff attributed the large reduction in sales to the weather. Calendar Year 2003 was a rainy year.
- Increase in Operation and Maintenance Expenses: The operation and maintenance expenses increased by approximately \$495,000, or 8.4%, when comparing this year's rate case to the prior rate case. This is well above the rate of inflation and occurred when less water was sold. Staff could not find an explanation in the rate case material for such a large increase in these expenses.
- Large Rate Increase: The Water Company invested an additional \$2 million in improvements to the water system that supports Alexandria customers since the last rate

request and is entitled to receive a return on its investment. However, the rate increase requested by the Water Company would generate \$1.1 million in revenue based on the low sales of water. If expenses could be controlled, the Water Company would recoup its investment in less than two years.

In prior rate cases, after an extensive expert audit of the Water Company finances and its rate filing documents, the SCC has often concurred with many issues identified by City staff. In addition, the SCC has raised additional items which have resulted in the Water Company withdrawing the rate request or the SCC approving rate increases substantially lower than requested. In 2001 and 2002, staff did not send comments to the SCC concerning the Water Company. In both years, staff found that the rate case documentation contained sufficient information to support a rate increase. The last Water Company rate increase the SCC approved for the City of Alexandria was a 2.97% increase in 2000. At that time, the Water Company was requesting a rate increase of 5.21%.

**FISCAL IMPACT:** None.

**STAFF:**

Mark Jinks, Assistant City Manager

D. A. Neckel, Director of Finance